

Internal Revenue Service

Department of the Treasury

District
Director

P.O. Box 1680, GPO Brooklyn, N.Y. 11202

Date: OCT 17 1986

Person to Contact:

Contact Telephone Number:

Refer Reply to:

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption under section 501(c)(7) of the Internal Revenue Code.

The evidence presented indicates that you were incorporated on [REDACTED] under Chapter [REDACTED] of the General Laws of [REDACTED].

The purposes for which the corporation was formed are, "to prompt the physical, mental, and character development of boys and girls, men and women, by providing such means of recreation, training, education, and guidance as in the judgement of the directors achieve this purpose."

Your activities consist of various social and recreational activities for members. The majority of these activities are conducted in a four story brick building which you own subject to a mortgage. You indicated in a response to a request for additional information that the public is "welcome to participate (sic) and come into the Club Facility." An analysis of Form 1024 and your response to an additional information requests that you rent two "units" to outside parties without a written lease, with rental receipts comprising [REDACTED]% of total receipts for the years [REDACTED], [REDACTED], and [REDACTED]. Finally, you indicate that the Club furnishes life insurance to members, valued at \$[REDACTED] upon the death of the policyholder, double indemnity if death is accidental.

Section 501(c)(7) of the Code provides exemption to clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities. Public Law 94-568 amended IRC 501 to reflect a twofold change under IRC 501(c)(7). First, it makes it clear that a social club may receive some investment income without losing its exempt status. Second, it permits a higher level of income from nonmember use of club facilities than was previously allowed.

In addition, Public Law 94-568 defines gross receipts as those receipts from normal and usual activities of a club including charges, admissions, membership fees, dues, assessments, investment income, and normal recurring capital gains on investments, but excluding initiation fees and capital contributions. Public Law 94-568 also states that it is intended that social clubs should be permitted to receive up to 35 percent of their gross receipts, including investment income, from sources outside of their membership without losing their exempt status. Within this 35 percent amount, not more than 15 percent of the gross receipts should be derived from the use of the social club's facilities or services by the general public. Thus a social club may receive investment income up to the full 35 percent amount of gross receipts. If a club receives unusual amounts of income, such as from the sale of its clubhouse or similar facility, that income is not to be included in the 35 percent formula; that is, unusual income is not to be included in the gross receipts of the club.

Revenue Ruling 66-149, 1966-1 C.B. 146 holds that a social club is not exempt from Federal income tax as an organization described in section 501(c)(7) of the Code where it regularly derives a substantial part of its income from nonmember sources such as, for example, dividends and interest on investments which it owns. However, a club's right to exemption under section 501(c)(7) of the Code is not affected by the fact that for a relatively short period a substantial part of its income is derived from investment of the proceeds of the sale of its former clubhouse pending the acquisition of a new home for the club.

Revenue Ruling 69-220 C.B. 1969-1 154 describes an organization with income consisting of initiation fees, dues, assessments, and rent. The gross rental income was used to pay the operating expenses of the building including the part used by the organization total rental income amounted to 75% of total receipts. Exemption was denied in this case as it was held that the organization was regularly engaged in a business ordinarily carried on for profit and because net income from the activity inured to members in the form of lower cost of improved facilities available for their use.

(3)

Revenue Ruling 63-190 C.B. 1963-2 212 held that an organization which maintained a social club for its members as described in section 501(c)(7) and in addition pays sick and death benefits to its members does not qualify for exemption from Federal income tax within the meaning of section 501(c)(7).

Like the organization in Revenue Ruling 66-149, the instant an organization regularly derives a substantial portion of its income from nonmember sources, such as rental income on property which it owns. Also as in Revenue Ruling 69-220, rental income is used to pay expenses generated by all parts of the building, ultimately benefitting members. In addition, investment and nonmember income has constituted more than the 35% limitation as stated in Public Law 94-568 for the years [REDACTED], [REDACTED], and [REDACTED].

Finally, the payment of sick and death benefits to members is an activity which is inconsistent with the social and recreational purposes specified by section 501(c)(7) and precludes recognition of exemption.

Accordingly, we conclude that you do not meet the requirements for exempt status under section 501(c)(7) of the code and propose to deny your request for exemption under that section.

We have also determined that you fail to qualify for exempt status under any other subsection of IRC 501(c).

You are required to file a taxable return Form 1120 or 1041 with the District Director of Internal Revenue Service. Please send the return to the Internal Revenue Service, P.O. Box 1680, General Post Office, Brooklyn, NY 11202.

If you do not agree with this determination, you may protest in accordance with the enclosed instructions within 30 days.

Protests submitted which do not contain all the documentation stated in the instructions will be returned for completions.

If we do not hear from you within that time, this determination will become final.

[REDACTED]
District Director

Enclosure: Publication 892